

EX PARTE OR LATE FILED



United States Telephone Association

1401 H Street, N.W., Suite 600
Washington, D.C. 20005-2136
(202) 326-7300
(202) 326-7333 FAX

September 15, 1994

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D. C. 20554

DOCKET FILE COPY ORIGINAL

RECEIVED

SEP 15 1994

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Re: Ex Parte Meeting
CC Docket No. 94-1

Dear Mr. Caton:

On September 14, 1994, representatives of the United States Telephone Association (USTA) held a series of meetings with Commission staff to discuss the above-referenced docket. Robert Harris, Whit Jordan, Ed Lowry, and Frank McKennedy, on behalf of USTA, met with Kathleen Wallman, Kathy Levitz, David Nall, Mark Uretsky and Dan Grosh of the Common Carrier Bureau staff and, in a separate meeting, with Robert Pepper of the Office of Plans and Policy. The viewpoints expressed were consistent with USTA's written filings in this docket.

In addition, on September 14, 1994, Nancy Lubermersky, Dennis Weller, Ed Lowry, Whit Jordan and Frank McKennedy, also on behalf of USTA, met with James Olson, Paul Gallant and George Ford of the Office of General Counsel, and in a separate meeting, with David Nall, Dan Grosh, JoAnn Wall and Anthony Bush of the Common Carrier Bureau. The attached written material was distributed and discussed at both of these meetings.

The original and a copy of this ex parte meeting notice are being filed in the Office of the Secretary on September 15, 1994 due to the lateness of the meetings. Please include it in the public record of this proceeding.

Respectfully submitted,

A handwritten signature in cursive script, reading "Linda Kent", is written over the typed name.

Linda Kent
Associate General Counsel

Attachment

cc: Anthony Bush
David Nall
Mark Uretsky
Dan Grosh

Kathy Levitz
Robert Pepper
James Olson
Paul Gallant

JoAnne Wall
Kathleen Wallman
George Ford

No. of Copies rec'd
List ABCDE

021

**To Meet Its Policy Goals in 94-1
The Commission Must Adopt
an Adaptive Regulatory Framework**

Markets have changed dramatically since 1984

- **Technology**
- **Competition**
- **Rate of change is accelerating**

Existing access rules not designed for these changes

USTA proposes adaptive framework for price cap regulation

- **Adaptable rate structure**
- **Framework that adjusts degree of regulation to match degree of competition**

Competitors have targeted areas with dense concentrations of traffic and revenues

CONCENTRATION OF REVENUES

- Ameritech: 15% of business accounts--> 72% business revenues
- Bell Atlantic: 15% of wire centers--> 71% special access revenues
- BellSouth: 4% of wire centers--> 30% business revenues
- New York Tel: One central office has more MOUs than all of Vermont
- SWBT: 11.5% of central offices--> 60% total access revenues
- GTE: 6% of end users--> 46% of switched, MOUs
.6% of end users locations yield 100% Special Access Channel Terminations

<u>Geographic area</u>	<u>Percent of land area which yields percent of business revenues</u>	
10 large States	1%	30%
	8%	75%
Pacific Bell	5%	85%
New York	10%	90%
Washington	1%	50%

Who are the competitors?

CAPs

- CAPs serve all 25 of the top MSAs; that represents 43% of US population
- CAPs will have presence in more than 260 cities by year end 1994
- 500% growth rate projected for the next 5 years
- CAPs are large, well-financed businesses
 - MFS' parent, Peter Kiewit & Sons, is 11th largest privately owned US corporation with almost \$5B in revenues
 - TCG is owned by 5 cable companies and has over \$12B in assets
- Less than 10% of CAP fiber capacity is being used to transport traffic today
- It is easy for CAPs to expand their customer base:
 - If current ring is within reach of building, CAP extend a link over to that building; building owners often allow access to CAPs as a selling point to prospective tenants.
 - If building is not within reach of the existing ring, CAPs can extend their own ring or use existing rights of way from other utilities, transit companies, etc.
 - If additional new capacity is needed, CAPs need only install new fiber optic terminal rather than additional fiber.
 - If unique customer need exists, they find a partner to help meet that need

IXCs

- Self-provisioning their own backbone networks
- Have installed over 100,000 fiber miles with other utility rights-of way
- Affiliations and informal relationships with other providers expand market capability:
 - ATT-McCaw
 - MCI-British Telecom
 - Sprint-France Telecom and Deutsche Telekom

Cable companies' entry into telephone is imminent: their networks are nearing ubiquity

Cable companies:

- **Pass over 95% of television households today**
- **Deploy fiber and coax/fiber mix**
 - Use of fiber optics has increased 600% since 1988
 - 77% of national cable installations are capable of 2 way communications
- **Are buying switching equipment**
 - Several cable companies are currently offering telephone services
 - Networks are used for backhaul of voice and data transmissions for both cellular and CAPs
 - Consortium of 6 cable companies issue a joint RFP for \$2Bworth of telephony switching equipment
 - FCC Staff Report estimated cost of adding telephone to cable at \$207/line
 - Equipment vendors estimate cost less than \$300/line
 - C.W.Post-Cablevision alliance bypassed New York Tel
- **Affiliations with CAPs and IXC's**
 - Cable interests now control 50% of CAP revenues
 - Five cable companies own TCG
 - MCI-Jones Intercable testing phone service over cable in Alexandria, Va.
- **Affiliations with LECs**
 - USW in Atlanta (Wometco) and Rochester(Time Warner)
 - SWBT in Maryland (Hauser)
 - BellSouth owns 22.5% of Prime Management which owns Prime Cable
- **Offer cable telephone service to 15% of UK homes passed and to 70% of homes that subscribe to cable.**

Acceptance of wireless technology is skyrocketing as costs and prices decrease Cellular was expected to supplement wire-based communications and to stimulate use of local networks. Wireless communication is beginning to replace conventional wireline telephony.

Cellular

- **Affiliations and arrangements with IXC's and CAPs allow immediate entry into access markets**
-2/3 of non-wireline companies have transport contracts with CAPs, thereby bypassing LEC transport
- **As of 12/93, there were 16M subscribers, expected to reach 35M by end of decade**
-8000 US customers sign up every day
-The number of cellular subscribers increased more than landline subscribers in 1992

PCS

- **FCC auctions for 2,071 licenses will begin in December 1994**
- **FCC projects 60M PCS users in US in next 10 years**
- **Bert Roberts of MCI predicts 90M users by 2000**
- **PCS is expected to penetrate 40% of residential market**

Utilities and End Users are also offering services to Interstate Access customers

Electric, Gas, and Water Utilities

- 50% of utility providers have planned or have built fiber ring backbone networks
- Only 5% of the fiber capacity is now being used by the utility remainder is being offered for private use or for resale

End Users

- PBXs and private customer networks provide switched services
 - Direct link to IXC POP
 - SDN-type services
 - Smart PBXs in campus settings
 - CW Post University-Cablevision
 - Governmental entities self-provisioning or bargaining with CAPs for services
- VSAT, a previously thought to be declining technology, is flourishing
 - Walmart, Chevron, and 7-11 have installed VSATs at thousands of sites nationwide
 - over 1000,000 terminals are in service with 54% growth since 1992

The claims of CAPs and IXC's about 99% LEC market share distort the view of interstate access competition; they ignore self supply by ICs, end user purchases of access (whether from a LEC or from a CAP), wireless and cable competitive alternatives.

Review of market share claims:

**switched and special access purchased from LECs
switched and special access+ IXC self supply +end user purchase+CAP+Wireless+VSAT+private**

- **Review of revenue share claims**
- **In 10 metro areas of 5 large LECs, CAPs have 30% market of HICAP services**

Assessment of Competition in Access Markets

What is purpose of examining competition in 94-1?

- **In the Docket:**
 - **To determine whether adoption of an adaptive framework is warranted**
- **Once an adaptive framework is adopted:**
 - **To determine when streamlining is warranted**
- **What is the relevant market?**
- **Access (not local)**
- **Geographically limited (not nationwide)**
- **Based on broad groups of substitutable products (not individual services)**

LECs face real competition for their core lines of business today

**USTA's Proposed Framework
To Adjust Regulation
To Match Competition**

- Key Elements

- **Definition of Market Area**
- **Market Area Classification**
- **Criteria for Classification**
- **Pricing Rules by Market Area**

1) Definition of Market Area:

- **Geographic area served by one or more wire centers**
 - **Smallest unit of observation**
 - **Pre-existing entity**
 - **Matches existing billing, ordering systems**

2) Market Area Classification

- **Three levels of markets:**
 - **Initial Market Areas (IMA)**
 - **Transitional Market Area (TMA)**
 - **Competitive Market Area (CMA)**
- **Builds upon existing zone plan**
 - **Each zone becomes an Initial Market Area (IMA)**
- **Within an IMA, wire centers may become part of a TMA**
 - **Upon showing of presence of a competitor**

- Individual wire center may be designated as a CMA
- Upon showing that competition is sufficient to limit market power
- Alternative source of supply must be available for customers within the serving area of the wire center representing at least 25% of the incumbent's existing interstate access services demand, or alternatively for 20% of the total market demand within that area,

and

Customers within the serving area of the wire center representing at least 25% of the incumbent's existing interstate access services demand within that area, or alternatively a single customer representing at least 15% of that demand, actively demonstrate(s) a willingness to utilize alternative sources of supply.

- Showing may be made for all access services, or for one or more price cap baskets

3) Criteria for Streamlining

- Addressability
 - Measures market power directly
 - Forward-looking indicator
 - Asks whether customers have choices
 - Incorporates best existing economic theory
 - Elasticity of alternative supply
 - Ability (capacity) to supply
 - Based on real, not potential, competition
 - Facilities in place
- Other Proposed Criteria are not Reasonable
 - Market Share
 - Measures choices customers have made, rather than those they have available
 - Not directly related to market power
 - Backward looking; establishes pricing signals only after market decisions have been made
 - Presupposes market outcome
 - "Reserves" portion of the market for entrants
 - "Structural" Preconditions

- No significant barriers to access markets
- Proposed conditions relate to local, not access, competition
- If Addressability condition met, entry has already occurred

4) Pricing Rules

- **Proposed Criteria and Pricing Rules Effectively Protect Consumers, Competition**
 - **Prices too high**
 - Caps in areas where market power still exists
 - **Prices too low (predation)**
 - Price floors at incremental cost
 - Recoupment unlikely
 - Increasing competition
 - Streamlining granted only when competitors have sunk capacity
- **Cross-subsidy**
 - Caps on less competitive markets
 - Independent of pricing decisions in more competitive markets -- because sharing and LFAM eliminated
 - Floors on all rates
- **Vertical Price Squeeze**
 - Addressability criterion does not rely on interconnection
 - Streamlining granted only when customers have choices through competitors' own facilities
- **Discrimination**
 - Rates not unreasonably discriminatory simply because they are different
 - Existing policies on discrimination, resale, sharing continue to apply
- **Regulation should replicate competitive outcome**
 - Depart from symmetry only where necessary
 - Use least distorting regulatory tools
 - More "protection" not better for consumers
 - Litmus test for pricing proposals
- **Pricing Rules proposed by other parties are not reasonable**

- **Cost consistency (MFS)**
- **Linking across services (Wiffel, ICA)**
 - **Do not pass litmus test**
 - **Raise cost of competitive response for LECs**
 - **Increase risk, reduce rewards for new services**

**The Commission Should Adopt
an Adaptive Framework Now**

- **Benefits of adaptive framework**
 - Establishes clear ground rules for competition up front
 - Provides reasonable expectations for all players
 - Undistorted market signals to guide entry, investment, purchase decisions
 - Efficient development of NII
 - Immediate benefit in all markets
 - Replicates market outcome
 - In competitive markets, by allowing market forces to work
 - Consumers benefit from lower prices, more effective competition, wider choice of services.
 - In less competitive markets, by protecting consumers
 - Effective protection from abuse of market power, anticompetitive behavior
 - Facilitates introduction of new services
 - Allows prompt, efficient regulatory response
 - No need for new proceeding every year to assess changes in market
- **There is no downside to adopting a framework now**
 - Streamlining would be granted only where LEC has shown that criteria are met
- **Time to establish trigger mechanism and ground rules for competition is now**
 - Not after investment decisions have already been made
 - To permit rational development of competition

Transition of Market Area Classification

